

The Manufacturers Hanover Financial Digest

Weekly Commentary,
Selected Financial Data,
and Business Indicators

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The Most Difficult Choices . . .

One of the more widely accepted reasons for the powerful rallies that recently occurred in the debt and equities markets was the belief among investors that not only has the Federal Reserve substantially eased its restrictive monetary policy stance, but that it has also backed away from the monetarist operating principles which have guided its policy actions since 1979, and begun to pay attention to interest rates once again. But as the most recently published minutes of the Federal Open Market Committee (FOMC) make clear, such beliefs may not be correct. While expressing concern over the soggy pace of business activity, rising bankruptcies and the sluggish rate of money supply growth, the FOMC also reaffirmed its commitment to monetary targeting in general, and the 1982 growth targets in particular. Although it was agreed that monetary growth near the upper ends of its annual target ranges would be tolerated, this is a far cry from the abandonment of either monetary restraint, or of monetarism.

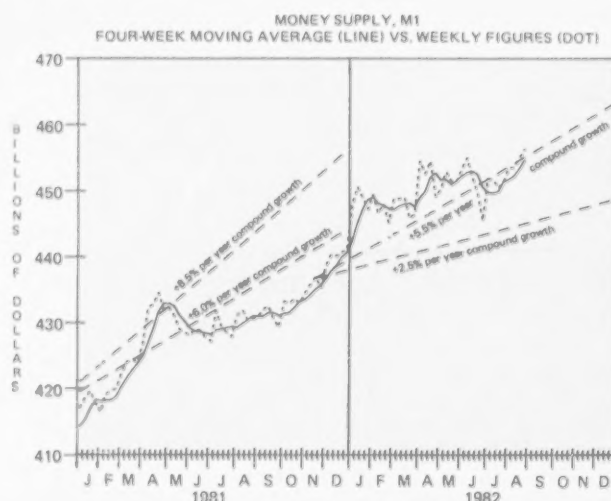
This is not to suggest that Fed actions did not play a major role in the recent easing of bank reserve positions, and the declines in short-term interest rates. In fact, the Fed was instrumental in establishing the conditions for this to occur. But so far, at least, the loosening of the credit reins by the central bank has neither been at the expense of its credibility in the fight against inflation, nor in violation of its 1982 money growth targets. For faced with an economy that was virtually stagnant, as well as mounting liquidity difficulties in both the industrial and financial sectors of the economy, the Fed stepped up its efforts to accelerate M1 growth—but only after it had tumbled below the central bank's 5½ per cent upper target boundary in late June.

As substantial policy leeway emerged, the Fed moved quickly to increase reserves in the banking system and initiated a series of one-half percentage point discount rate cuts. At the same time, since the banking system's need for reserves actually declined between the end of June and the middle of August, this resulted in a sharp imbalance between the

supply and demand for reserves, thus exerting downward pressures on all reserve-related interest rates.

. . . For The Federal Reserve . . .

With interest rates dropping and nonborrowed reserve growth accelerating, many observers concluded that the Fed was again emphasizing interest rate, as well as money supply objectives. But it is all too often forgotten that, in the monetarist framework, money supply growth which is too sluggish can be just as damaging to the real economy as too much growth can be to inflation expectations. Thus, with M1 plunging at a five per cent seasonally adjusted annual rate in June and falling well within its annual growth target boundaries, the monetary authorities were presented with a tempting "window of opportunity" to ease the credit reins and push short-term interest rates lower—but without adverse effects on either inflation expectations or its operating philosophy.



Reflecting at least partially the generous pace of nonborrowed reserve provisioning in recent months, M1 growth has indeed leaped higher. Expanding at a seasonally adjusted annual rate of well under three per cent during the 13 weeks ending August 25, the money supply rose at a rate of over nine per cent



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during the month ending on the same date. What is more, M1 has risen from just \$2.1 billion above its **lower** growth target boundary since the end of June to \$1.2 billion above its **upper** growth target boundary, during the final week in August. (See chart on page 1.)

The economy may have even begun to stir slightly. The index of leading economic indicators and factory orders both turned higher in July, while the erosion of consumer and business confidence has apparently slowed. But what these developments may have done is to bring monetary policy much closer to a critical crossroads. With money supply growth already accelerating (and now above target),

the combination of a modest business rebound and past monetary policy stimulation could turn what was initially thought to be a temporary midsummer money bulge—due to increased Social Security payments and cuts in personal income tax rates—into a prolonged period of monetary excess. If so, just as the slowing of money supply growth raised a welcome window of opportunity, its acceleration may close it, raising the possibility of a firming of the credit reins at precisely the same time that recovery is getting under way. Alternatively, neglecting a sharp and prolonged run-up in money supply growth could be just as damaging, if not to the economy, then to the Fed's inflation-fighting credibility, and certainly to its monetarist principles.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 9/1/82	% Change Since	
		Week Ago	Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies			
Owned Outright & RPs	141.979	— .258	+ 8.378
Loans to Depository Inst.	.507	— .102	— .941
Float	1.584	— .282	— 1.232
Total Reserve Bank Credit	153.223	— .589	+ 6.569
Treasury Deposits with			
Federal Reserve Banks	3.157	+ .285	— .262
Currency Outside Banks	131.967	— .880	+ 8.154
Member Bank Reserves:			
Required	40.071	+ .029	— .762
Excess (Deficiency)	.387	+ .118	+ .028
Total Reserves Held	40.458	+ .147	— .734
Net Borrowed Reserves	.025	— .221	— .818
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	93.985	— .512	+ 2.148
Monetary Aggregates †		% Change Since	
		Three Months Ago*	Year Ago
M1	457.1	+ 2.8‡	+ 5.7‡
M2 (August '82)	1,946.1	+ 10.2	+ 9.8
M3 (August '82)	2,355.3	+ 13.3	+ 10.8
L (April '82)	2,752.3	+ 12.7	+ 12.1

† Seasonally adjusted.

* Seasonally adjusted annual rate.

‡ Four-week moving average.

New York Money Market

Offering Rates 9/10/82	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	8.30%	9.60%	10.10%
* Federal Agencies	8.80	10.25	10.90
* Project Notes—Taxfree (46% Taxable Equivalent)	8.33	9.63	11.48
Negotiable Time CDs	Rates By Arrangement		
Manufacturers Hanover	10.55	11.70	12.38
* Secondary Market—Prime			
‡ Finance Company Paper—Prime		‡ Bankers' Acceptances	
5- 14 days	9.88%	Oct.	10.10%
15- 29 days	10.00	Nov.	10.25
30- 59 days	10.13	Dec.	10.45
60- 89 days	10.13	Jan.	10.90
90-179 days	10.13	Feb.	11.10
180-239 days	10.13	Mar.	11.10
240-270 days	10.13		
‡ Industrial Paper—Prime		† Federal Funds Effective Rate	9.90%
30- 89 days	10.00%		
90-120 days	10.13		
‡ Discount basis.		* Subject to availability.	† Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period	Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'82	\$ 3,041	\$ 2,996
Gross National Product (1972 Dollars)*	2nd Q'82	\$ 1,475	\$ 1,471
Percent Change, Annual Rate	2nd Q'82	1.3	— 5.1
Change in Consumer Prices (all urban consumers)*	Jul '82	7.2%	12.0%
Change in Producer Prices*	Aug '82n	7.2%	7.2%
Civilian Employment (Thousands of Persons) †	Aug '82	99,839	99,732
Unemployment as % of Civilian Labor Force †	Aug '82	9.8%	9.8%
Personal Income*	Jul '82	\$ 2,592	\$ 2,567
Leading Indicators Composite Index (1967=100) †	Jul '82	129.8	128.1
Industrial Production Index (1967=100) †	Jul '82	138.1	138.2
Net Change in Consumer Installment Credit †	Jul '82n	\$ 0.57	\$ 1.35
U.S. Merchandise Trade Balance †	Jul '82	—\$ 2.42	—\$ 3.44
Plant and Equipment Expenditures*	3rd Q'82	\$328.04(a)	\$336.77(a)
Private Housing Starts (Thousands of Units)*	Jul '82	1,211	906
New Construction Expenditures*	Jul '82	\$ 228.5	\$ 230.2
Total Business Inventories †	Jun '82	\$ 512.0	\$ 510.4
Total Business Sales †	Jun '82	\$ 344.5	\$ 349.1

* Seasonally adjusted annual rate.

† Seasonally adjusted.

n—Newly reported figure.

a—Anticipated.

... May Be Yet To Come ...

Judging by the euphoria currently sweeping the equities markets, traders and investors appear convinced that the monetary reins will not be tightened no matter what happens to the money supply. This is because the U.S. economy finds itself perched between a tepid recovery on the one hand, and enduring recession on the other. The debt markets, primarily the bond markets, already laboring under the swelling tide of new Treasury offerings, appear somewhat less convinced. In fact, both may eventually be proved correct.

According to the FOMC minutes of the June 30-July 1 meeting, the Fed "... would tolerate for

some period of time growth somewhat above the target range should unusual precautionary demands for money and liquidity be evident ... " Although still uncertain, perhaps that period of time will be sufficiently long to get a sustainable recovery under way, but not long enough to prompt another surge in the major price indexes or a sharp deterioration of bond market conditions. Only time will tell and, of course, the monthly trends in the money supply statistics.

... At Home And Abroad

The difficult decisions facing the Federal Reserve are not confined to domestic problems. The agendas of the International Monetary Fund (IMF) and

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Year Ago
Negotiable Time CD's			
Weekly Reporting Banks			
Nationwide (8/25/82)	149,798	+ 1,158	+21,215
New York City (8/25/82)	40,227	+ 455	+ 9,368
Commercial Paper (8/25/82)	176,646	- 1,672	+21,598

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans			
	Latest Week	Change Since Week Ago	Year Ago
Weekly Reporting			
Large Commercial Banks			
Nationwide (8/25/82)	210,310	- 760	+26,972
New York City (8/25/82)	59,057	- 192	+ 5,665
Total Loans Gross Adjusted			
	Latest Week	Change Since Week Ago	Year Ago
Nationwide (8/25/82)	489,586	- 2,184	+41,723
New York City (8/25/82)	115,985	- 197	+10,117

Financial Markets

	Friday 9/10/82	Change Since Week Ago	Year Ago
U.S. Governments, Closing Yields:			
90-Day Billst	8.59%	+ .05	- 5.93
180-Day Billst	10.35	+ .25	- 4.49
Longest Billst	11.10	+ .21	- 3.31
Recent Issues:			
11 ⁵ /8s 8/31/84	11.91	+ .26	
147/8s 6/30/86	12.59	+ .06	
133/4s 5/15/92	12.64	+ .20	
14s 11/15/11	12.37	+ .18	
Municipals:			
Bond Buyer-20 Bond Index* (9/9/82)	10.75%	+ .01	- 2.46
Blue List Total (\$ Million)	\$ 994	- \$171	+ \$ 410
30-Day Visible Supply (\$ Million)	\$3,083	+ \$562	+ \$1,490
Total	\$4,077	+ \$391	+ \$1,900
Corporates:			
Moody's Aa Composite (9/9/82)	13.86%	- .12	- 2.09
30-Day Visible Supply (\$ Million) ‡	\$1,030	- \$380	NA
Stocks:			
Dow-Jones Averages:			
Industrials	906.82	- 18.31	+ 34.01
Transportation	369.60	- .08	+ 11.20
Utilities	114.48	- 2.81	+ 7.21
65 Stocks	354.17	- 5.35	+ 14.22
Standard and Poor's 500 Stocks	120.97	- 1.71	- .64
N.Y.S.E. Composite Index	69.41	- .85	- .91
N.Y.S.E. Avg. Daily Vol. for Week (000's)	72,923	-13,957	+ 28,125

* 46% Taxable equivalent 19.91%.

‡ Series redefined: Historical data not available.

† Bond equivalent.

International Rates

	Friday 9/10/82	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	10.63%	10.38%
1 month	11.25	11.00
3 month	11.88	11.50
6 month	12.81	12.50
1 year	13.13	13.00
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	13.50%	13.37%
Long Term (7 to 15 yrs.)	13.65	13.57
FOREIGN EXCHANGE SPOT RATES		
New York Opening (9/10/82)	U.S. \$ Equivalent	Currency Per U.S. \$
Belgium	.02079	48.09
Canada	.8086	1.2367
Denmark	.1120	8.9285
France	.1411	7.0850
Germany	.3996	2.5025
Italy	.0007087	1411.00
Japan	.003815	262.15
Mexico	.008696	115.00
Netherlands	.3644	2.7440
Switzerland	.4681	2.1363
U.K.	1.7145	.5833

World Bank meetings in Toronto last week were filled with issues which deeply affect the Federal Reserve and U.S. commercial banks.

One of the more vexing problems is the current number of debt reschedulings and the possibility of more to come. It would appear that several nations have incurred levels of external debt which exceed their present ability to repay. High interest rates in recent years, as well as the necessity to borrow short-term, have imposed sizable debt service burdens on these countries. At the same time, the current world recession has not only reduced the size of the market for their exports, but the prices they receive as well. Thus, the borrowing countries, most of which are newly developing, have been hit from both sides.

Additional financial help is needed, but the range of options is not great. If the borrowing nations which find themselves in difficulty are not accommodated through a rescheduling of their debt then *de facto*

default is a serious possibility. But debt rescheduling must involve not only the establishment of a feasible repayment plan, it also must involve a measure of financial discipline for the borrowing nation. Debt rescheduling must not be an easy option for borrowers.

The implications of extensive rescheduling of sovereign debt by a number of large national borrowers are certainly a matter for concern. If the central banks of the major industrial nations (including the Federal Reserve) continue to follow monetarist policies by limiting the growth in world credit availability, commercial banks may find it necessary to reduce their lending to the less developed countries. This, in some cases, might lead to default. On the other hand, accommodation of the expanded credit needs of the less developed countries, either through increasing the resources of the IMF and World Bank, or by encouraging commercial banks to add to their already large exposure, might eventually lead to the creation of excess liquidity, hence a new round of inflation. ■

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